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ANNUAL REPORT 1986

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AGT

AGT *80 YEARS OF EXCELLENCE*

AGT is an Alberta crown corporation established in 1906 as Alberta's public telephone system. Today, it is one of Canada's largest telecommunications companies providing a broad range of telecommunications services to the 2.4 million residents of Alberta.

Regulated by the Alberta Public Utilities Board, AGT operations include local service, long distance service, business systems, terminal equipment, mobile communications, and end-to-end network service for voice and data customers. As a member of Telecom Canada, AGT also delivers global voice and data services. Through its subsidiaries and joint venture, the Company sells Alberta communications expertise to the world and contributes to the industrial diversification of the province.

The Company, which has 11,407 employees, is one of the largest employers in Alberta.

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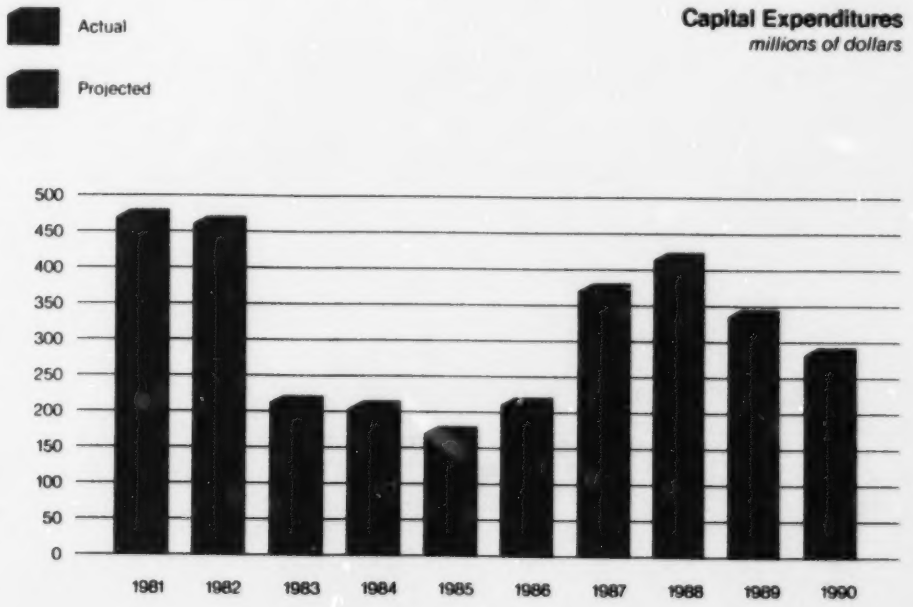
AGT 1986 SELECTED HIGHLIGHTS

1. *AGT undertook a corporate restructuring to meet the needs of a changing environment and technological advances.*
2. *AGT developed a new visual identity to reflect the newly-positioned organization.*
3. *AGT was named "Official Supplier of Telecommunications Services to the XV Olympic Winter Games".*
4. *Cellular Plus service was introduced and Calgary's first 800 MHz service was implemented.*
5. *AGT obtained the exclusive rights to the Canadian-designed Panther electronic key telephone system for companies in need of a small "packaged" phone system.*
6. *Satellite coin telephone service was introduced to Maligne Lake, Sunwapta Falls and the Columbia Icefields.*
7. *Altel Data and Business Communications were amalgamated under Business Systems, thereby integrating voice and data systems to better service the needs of business customers.*
8. *Major and National Accounts was created to serve the complex needs of major business customers.*

HIGHLIGHTS

	Percentage Change	1986	1985
		(Millions)	
FINANCIAL			
Operating Revenues	.3	$ 1 067.1	$ 1 063.5
Operating Expenses	4.3	771.4	739.9
Net Income	29.4	63	48.7
Cash Generated from Operations	7.5	228.7	212.7
Capital Expenditures	25.2	226.2	180.7
Plant Investment - Gross	4.3	3 146.5	3 015.7
- Net	(1.1)	1 888.2	1 909.6
OPERATIONAL			
		(Thousands)	
Subscriber Lines in Service	2.5	938.1	915.2
		(Millions)	
Long Distance Messages	5.1	248.2	236.2
Messages Per Line	2.7	265	258



AGT *A YEAR OF PROGRESS*

CHAIRMAN'S REPORT

AGT has a long history of providing reliable, affordable, and innovative telephone service for Albertans. We play a critical role in supplying telecommunications for individual use, for business, and for the economic development of the province. Now in the midst of the 'information age', Alberta's future growth will heavily rely on its ability to maximize the opportunities that new technology affords. The prospects are exciting.

To meet this challenge AGT initiated, in 1984, a five-year directional plan. Now, two years into that plan, we are well organized to stride confidently toward the 1990s.

The new structure of the Company is creating an environment conducive to individual initiative and, on behalf of the Commission, I thank all members of the AGT team for their contribution to the progress made in 1986. The dynamic changes in the telecommunications industry will continue to demand innovation, creativity and dedication to customer needs and we will be required to respond to these challenges with enthusiasm and commitment.

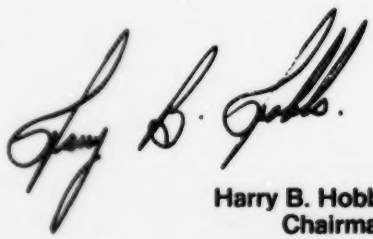
During the year the Department of Technology, Research and Telecommunications was consolidated under a new Minister, the Honourable Les Young. The Deputy Minister, Mr. Ken Broadfoot, joined the Commission, replacing Mr. Vance MacNichol, who made a tremendous contribution to the Commission. The Commission also lost the valued counsel of Joe Szaszkiewicz who resigned as President of ATI after a career spanning 33 years with AGT. He was succeeded by Mr. Graham Pollock, a highly-regarded executive in Alberta's international marketing community.

Highlighting the past year was the Government of Alberta's announcement of Individual Line Service for all Albertans and the extension of Flat Rate Calling to over one hundred communities. AGT also finalized a contract with OCO'88 naming AGT as the official supplier of telecommunications services for the 1988 Olympic Winter Games. We all look forward to the excitement that this event will bring to Calgary, to the province, and to the world.

Throughout the year, there has been public discussion about the privatization of a number of crown corporations by the government. At this time, consideration is being given to a financial restructuring of AGT to improve our debt to equity ratio. The Company is financially sound, well-managed and well-positioned to meet our customers' needs now and in the future.

AGT's subsidiaries—Alta Telecom International, Alta Telecom Inc. and Alta-Can Telecom Inc.—and the joint venture, NovAtel, continued their exciting growth and contribution to Alberta's diversification in high technology, providing technical jobs for young Albertans.

The decade ahead will greatly test AGT's capabilities. There is a pressing need to adapt to new technology, to surging competition in the global marketplace, and to evolving regulatory changes. 1986 was a year of progress, innovation and growth. We are proud of our record for excellence in service and we are confident we will continue to meet these high standards in the months and years ahead.



Harry B. Hobbs
Chairman

PRESIDENT'S REPORT

Two years ago AGT embarked on a course of adapting the Company to cope with the emerging trends in our industry—the challenges of competition, regulation, technology and global communications. The need to adapt was imperative for the Company to compete successfully in tomorrow's market. Following a year which was highlighted by careful planning of the issues to be faced in this transformation process, 1986 was the year we began implementing the required initiatives and forging ahead to bring about change.

"Toward the 1990s"—our 'Statement of Mission' was distributed to all employees to ensure we all pull in the same direction and build on our strength—teamwork among dedicated people.

Implementation of the new organization structure was completed during the year. It provides for operating entities with closer links to their markets, a strengthening of corporate planning and management functions, decentralization of corporate support services such as finance, human resources, information systems and materials management and greater delegation of responsibility to the operating entities and functional divisions. As a result many managers assumed new and increased responsibilities and professionals were recruited from outside the Company to strengthen our capabilities in Finance, Corporate Communications and Human Resource Management. The appointment of Don Lowry as Senior Vice-President, Marketing & Sales made a welcome addition to the executive team.

In conjunction with the reorganization, a Corporate Management Framework was implemented to provide guidelines for Corporate Management, and to induce an entrepreneurial, innovative spirit with a strong customer orientation. While organizational structures and management systems are vital elements in reaching our long-term objectives, they are not our final goal—they simply allow us to serve our customers' needs in a more responsive way.

Clearly the management of change demands the very best from us all. True to tradition, our people have responded with a positive and professional attitude; our thanks to all of you! Although we have to stretch to ensure continued success, we have the talent, strength and people to make it happen.

From a financial perspective, AGT emerged from the difficult economic climate in Alberta with improved results over 1985. Consolidated Net Income increased by 29.4 percent from $48.7 million in 1985 to $63.0 million. Return on average capital remained at the 1985 level of 13.8 percent.

Our progress and achievements in serving our customers are detailed in the report that follows.

Of special note is the expansion program for improved telephone service launched in 1986. The three inter-related programs that comprise this major undertaking—the expansion of Extended Flat Rate Calling, the extension of Individual Line Service and the modernization of our network facilities—represents an investment of $500 million over the next five years. When this is completed, Albertans will have one of the most sophisticated, modern telephone systems in the world.

The successful implementation of these programs will be our top priority and our activities for 1987 will focus on:

- increasing our commitment to excellence in customer service
- strengthening the capabilities of our human resources and introducing management and financial systems to operate efficiently in the new business environment
- continuing our efforts to position the Company in an increasingly competitive environment
- expanding our research and development activities.

It is an ambitious agenda but one we can realistically accomplish with continued determination and initiative.

AGT's success in the years ahead depends on our commitment to meet the needs of our customers by effective strategic planning and the innovative use of technology to create new products, services and revenues—capture new markets—and reduce costs. Recognizing the importance of these key issues, we are well prepared to make our contribution to the future prosperity of Alberta.

Hal M. Neidner
President

Alberta

TECHNOLOGY, RESEARCH
AND TELECOMMUNICATIONS

Office of the Minister

404 Legislature Building, Edmonton, Alberta, Canada T5K 2B6 403/422-5982

Her Honour
The Honourable Helen Hunley
Lieutenant Governor of Alberta

Your Honour:

It is my pleasure to present the 1986 Annual Report of Alberta Government Telephones.

In the midst of a dynamic environment marked with competitive pressures and rapid technological advancement, Alberta Government Telephones has stayed at the forefront of new developments while maintaining the provision of universal telecommunication service at affordable rates for the citizens of Alberta.

The Report outlines the activities and accomplishments of AGT for the year 1986.

Respectfully submitted,

Les Young
Minister
Technology, Research
and Telecommunications

AGT

COMMISSION

The AGT Commission Board members for 1986 are:
seated left to right: *K.H.G. Broadfoot, Deputy Minister, Technology, Research and Telecommunications; R.A. Bickell, Chief Operating Officer and President Canfor Corporation; H.B. Hobbs, Chairman; A.F. Collins, Advisor - Provincial Treasurer; D.G. Skagen, Chairman, Mohawk Oil Co. Ltd.;*
standing left to right: *H.M. Neldner, President; F.S. Weatherup, Chairman, Saville Land Developments Ltd.; J.W. Burrows, Chairman, NovAtel Communications Ltd.; C.M. Leitch, Q.C., Managing Partner McLeod Dixon.*
not shown in this photo: *W.A. Graham, President, Gratrend Holdings Ltd.*

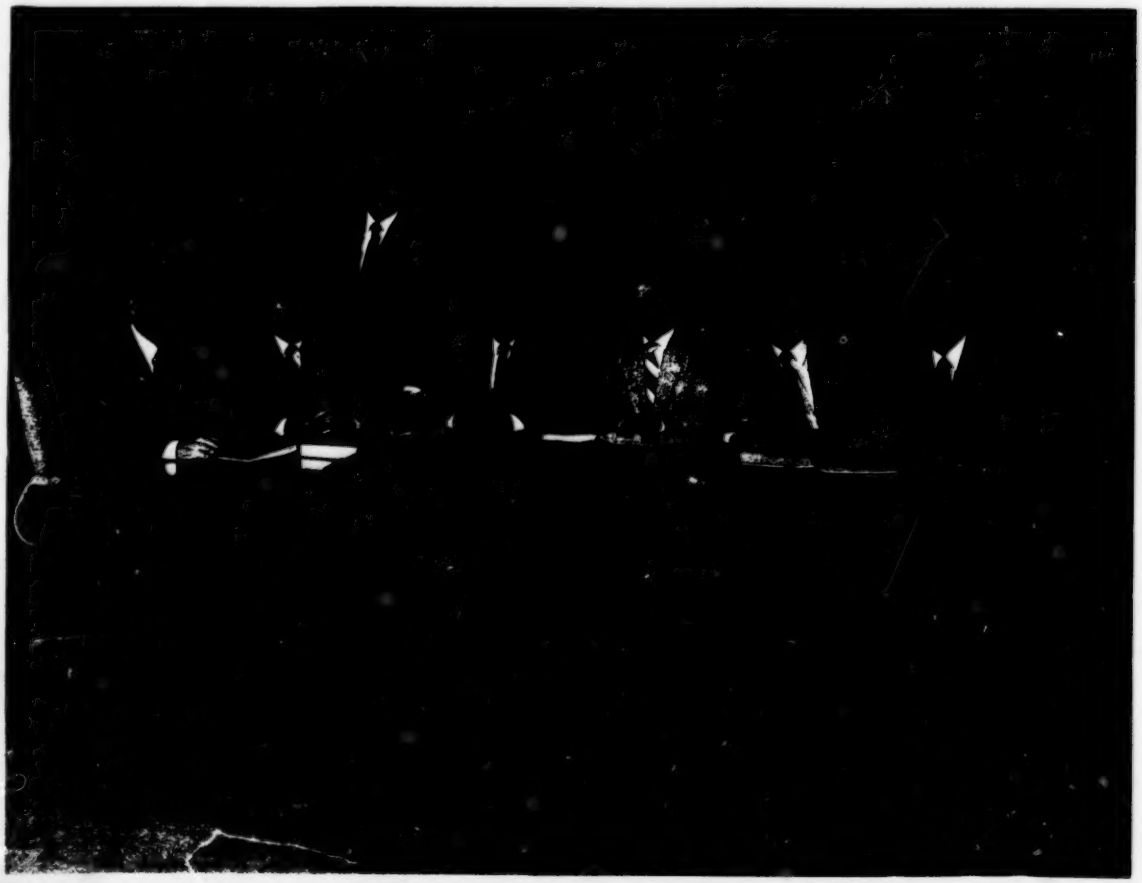
AGT A YEAR OF TRANSITION

1986 was a year of transition for AGT. Building on a foundation of careful planning, the Company was restructured to become a more market-sensitive organization, responsive to technological change and customer needs.

The reorganization delegates greater accountability to organizational divisions and establishes key profit units for major market segments. Corporate management functions were strengthened to provide common direction of business units, to analyze new opportunities and to co-ordinate all planning activities. Support functions work closely with the business departments of AGT to ensure greater operating efficiencies and excellence in customer services.

The new structure strategically positions the Company to meet a future of increasing competition and market change. It will enable AGT to expand its record of excellence in the years ahead.

The Corporate Management Committee directs AGT's ongoing activities. Left to right are: Frank Parrotta, Jim McDonald, Hal Neldner (standing), Don Baillie, John Thiessen, Don Lowry and Bill Montgomery.



MARKETING & SALES

AGT's primary objective is to respond quickly and efficiently to our residential and business customers. We strive to improve the quality of our telecommunications services to guarantee customer satisfaction. 1986 reflects that aim through the improvements and enhancements in residential services, business services, and in our network facilities.

Residential Services

The most significant aspect of improving AGT service this year was the announcement of the Extended Flat Rate Calling Program, the Individual Line Service Program and the Network Modernization Program. Combined, these three programs will result in one of the most advanced networks in the world. This enhanced network, in place within the next five years, will provide all Albertans with state-of-the-art telecommunications capabilities.

An important element of the AGT reorganization was the integration of all customer services under regional offices in seven centres throughout Alberta.

To maintain a high level of service, a Telephone Service Evaluation Program was initiated this year. Through this program, customers are interviewed by an outside agency and repair problems are quickly identified and corrected.

Another customer service initiative, an account adjustment system, went into effect in early December. The system reduces delays in processing adjustments and provides more accurate information flow between AGT and the customer.

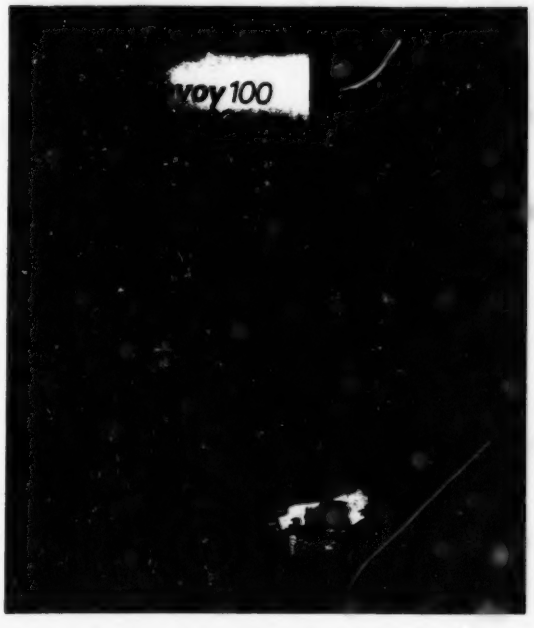
A new Phone Centre was opened in Banff offering customers the unique service of a private room to make long-distance calls with payment over the counter. Edson and Wetaskiwin were also provided with mini Phone Centres, raising the number of AGT residential retail outlets to more than thirty.

Satellite coin telephone service came to Maligne Lake, Sunwapta Falls and the Columbia Icefield—a progressive response to service for these remote mountain locations.

While competition for telephone products and accessories continues to increase, Residence Services introduced many product additions including new cordless phone models, improved speaker phones and an entire new line of telephone accessories.

Business Services

In the reorganization, Business Communications, the 'voice' division, and Altel Data, the 'data' division, were amalgamated under Business Systems. Now uniquely positioned to take a role in serving the Alberta business market, a number of significant initiatives have been introduced. For example, AGT acquired the exclusive rights to distribute the Canadian-designed Panther electronic key system. AGT also negotiated an agreement with Northern Telecom to offer the Vantage product line, which is manufactured in Calgary, on a rental basis. And, sales of Northern Telecom's SL-IS switchboard systems were made to the provincial government, the Calgary Public School Board and to other major customers.



Above: *Teleport terminals at Calgary and Edmonton International Airports allow travellers to access Telecom Canada's Envoy 100 and iNet 2000 electronic messaging and information services.*

Opposite: *The new Sherwood Park Phone Centre is one of more than 30 residential retail outlets in Alberta.*

CENTRON installations saw 500 additional lines in service in Lethbridge, Red Deer and Grande Prairie for a provincial total of 16,500. These city-wide integrated business networks provide all the features of an advanced PABX system with the switching equipment located at AGT central offices. Business Systems also introduced a new product enhancement called Integrated Voice Messaging.

In 1986, the revenue contribution of Mobile Communications grew by 6.2 percent. The increase was achieved by intensified sales effort and innovative marketing.

In May, CELLULAR PLUS service was introduced. At first, this applied solely to the provincially-based Cellular 400 and later in the year, expanded to include Cellular 800 service in Calgary. The 800 service gives customers access via Cellnet Canada to similar 800 MHz systems throughout North America. Cellular 800 service will soon be expanded to provide coverage in the Calgary-Edmonton and Calgary-Banff corridors.

AGT Directory saw an increase in revenue of 10.7 percent even though advertising rate increases were held to 2.5 percent. A major innovation was the debut of half-page 'Yellow Pages' advertisements. Sales of the half-page format exceeded the expected projections and generated 3.2 percent of total sales revenue. Production improvements within the directory also reduced costs. The prominence of the AGT 'Yellow Pages' hot air balloon over cities and rural areas continued to be an excellent promotion for Directory services.

Network Services

The strength of AGT is in its network. Its total telecommunications services are enriched by the fact that AGT is Alberta's total communications provider including voice, data and image transmission. In 1986, Network Services generated approximately 70% of AGT's total revenues.

With an increased emphasis on product development and product management this year, a Network Services Catalogue was developed to inform customers of AGT's total product line. This non-technical publication was distributed to every employee and to more than 120,000 Alberta businesses.

1986 introduced some major new and enhanced network products.

MEGAPLAN is a national service which gives business customers the advantages of sending high-speed data, voice and image signals over one digital channel. TELEROUTE 200 is a fixed-rate intercity 32-kilobits-per-second digital voice service designed to save heavy-use customers up to 35 percent.

TradeRoute Electronic Data Interexchange service combines two established services: Envoy 100 Electronic Mail and Dataroute. It is designed to trim customer costs, eliminate delays and reduce errors in processing purchase orders, invoices, shipping orders and other business forms.

Randy Hoffman, an AGT sales representative, demonstrates the Panther electronic key telephone system which answers the needs of many small business users.

iNET, the national information management network, was customized to meet the special needs of the Canadian Bar Association. It gives rapid access to such information as precedents, status of cases before the Supreme Court, and legal news.

DATAPAC, the packet-switched digital data network, expanded to 20 more centres in Canada and now serves 115 nationally. DATAROUTE also grew, adding seven more service areas in Alberta, making a total of 99 locations nationally.

Major and National Accounts (MANA) was established this year to better serve AGT's largest customer accounts by providing a strong focus on their complex and unique requirements. There has been an excellent customer response to the MANA concept.

Mobile radio technician, Len Webber, installs a cellular telephone.

MANA provides customers with a single contact to all of AGT's services. Through a detailed study of the customers' needs, a total telecommunications package is available.

Technological change has enabled competition to expand into AGT's traditional market areas. With its integrated systems solutions utilizing the strengths of all AGT divisions, MANA provides 'one-stop' shopping for all customer needs.

AGT

HUMAN RESOURCES

Commitment to excellence in customer service is the force underlying AGT planning and programs. Accountability is emphasized at all management levels in an effort to maximize the effectiveness and contribution of our most important resource—our people.

A major re-evaluation of all managerial positions, and a new compensation system based on pay for performance was developed in 1986. In addition, a series of Performance Management Workshops was held to assist managers at all levels with their new responsibilities. Emphasis was placed on high standards of performance to enable employees to grow to full potential and establish job satisfaction through achievement of corporate and individual goals. Training courses were held throughout the year to further emphasize customer satisfaction.

A new contract extending to April, 1988 was signed with Local 348, International Brotherhood of Electrical Workers (IBEW) covering traffic and clerical workers. Negotiations are continuing for a new agreement with the CRAFT bargaining unit of IBEW.

Productivity Improvement initiatives continue to play an important role in assisting managers to improve efficiencies in their respective areas, resulting in a positive impact on customer services. The estimated value of productivity improvement to date is $34 million in realized savings.

Further efficiencies were achieved by increasing the availability of the Professional Office System (PROFS). Thousands of employees now access this integrated electronic office system, which has significantly reduced paperwork and improved office communication. Computer upgrading was undertaken to serve AGT's office system needs well into the 1990s.

The Telephone Pioneers, North America's organization of telephone workers both actively employed and retired, celebrated their 75th Anniversary in 1986. The organization has a dedicated commitment to the well-being of community life. The Alberta Chapter's 1986 activities ranged from food-bank support to help for the handicapped, including children with speech problems. Their numerous ongoing projects also included active support of Ronald McDonald House.

Above: *AGT employees continually enhance their skills through training programs and workshops.*

Opposite: *The professional office system (PROFS) has significantly improved office communications.*

OPERATIONS

This year, AGT embarked on a major program, designed to upgrade telecommunications service for all Alberta residents and businesses. Over the next five years, the latest technological advancements will be integrated with existing facilities to provide one of the most advanced telephone systems in North America.

This initiative consists of three interrelated programs: the Extended Flat Rate Calling program, the Individual Line Service program and a Network Modernization program.

The Extended Flat Rate Calling (EFRC) program expands the current service to provide toll-free calling between certain communities within a forty-mile radius. Routes were identified based on customer requests and calling patterns. As a result, approximately 105 routes will be added over the next two years to the 256 routes already in service. The program ensures more convenient and affordable regional calling for many Albertans.

Throughout Alberta, there are approximately 100,000 customers currently on multi-party telephone service. Under the Individual Line Service (ILS) program, these customers will have the opportunity to subscribe to individual lines. The privacy and convenience of a private line are welcome additions for the multi-line customer.

Work began on three hundred telephone exchanges to upgrade them with state-of-the-art digital technology over the next five years. In addition to providing capacity for the new individual lines, it will provide future Integrated Services Digital Network (ISDN) access, allowing voice and data to be simultaneously transmitted. It will also enable AGT to develop a wide variety of enhanced services for customers.

Above: *Ron McDonald monitors network status data at the Calgary Broadband Operations Centre.*

Opposite: *Circuit boards are an integral part of AGT's telecommunications equipment.*

To meet the needs of ILS and network modernization, network switching plans have been redesigned to employ a host/remote configuration which will provide for full availability of service to non-urban subscribers.

Overall network reliability was a priority with measures taken to reduce the impact of cable cuts. To further enhance buried-cable service, a two-year program to provide air-pressure monitoring systems at all major exchanges was initiated. The systems isolate potential trouble spots caused by ground water, ensuring fast repair and fewer service interruptions.

Plans were also finalized for fibre optic systems between Camrose-Wetaskiwin, and Camrose-Vegreville. In preparation for the Telecom Canada national network fibre cable system, Outside Plant Standards were established to ensure the overall integrity of the system. Major installations were completed to further enhance the provincial cellular 400 and cellular 800 services.

A new Broadband Maintenance Alarm and Control System (BMACS) to improve network surveillance was put in place. The BMACS system continuously monitors and analyzes the performance of the network to ensure uninterrupted service. Through AGT's subsidiary companies, ATI and ATInc., other telecommunications companies are indicating interest in the system.

Above: *The fibre optic cable shown here will facilitate communications for the Olympics.*

Opposite: *AGT makes extensive use of fibre optics to provide Albertans with one of the most advanced telecommunications systems.*

PLANNING

AGT has placed an increased emphasis on the development of a co-ordinated approach to the planning of future-related and regulatory activities.

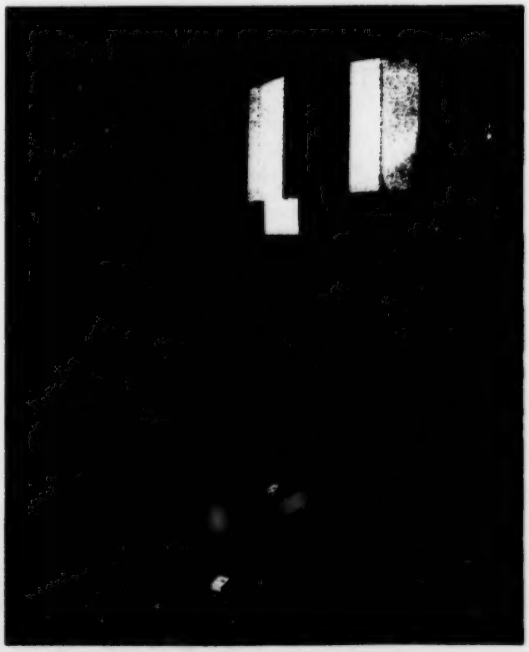
During the year, the directional plan was reviewed, updated and approved by the Commission. And, the formal process for the development of a strategic plan with a three-year time horizon was introduced to managers for their input.

AGT participated in several important regulatory proceedings throughout 1986.

On May 22, the Supreme Court of Canada granted AGT leave to appeal the 1985 Federal Court of Appeal judgment in favour of CNCP. According to that judgment, the CRTC was said to have the jurisdiction to hear CNCP's application to interconnect with AGT for private-line service. AGT's appeal will be presented to the Supreme Court with a decision anticipated sometime after 1987.

The committee arbitrating the toll revenue issue between AGT and 'edmonton telephones' briefly suspended its efforts after the untimely death of the Government of Alberta's appointee Dr. Hu Harries. Work resumed in October with Blaine Archibald, a former Public Utilities Board of Alberta member, as Dr. Harries' replacement. A decision on toll revenue sharing is expected early in 1987.

In November, AGT filed a General Rate Application with the Public Utilities Board of Alberta. The purpose of the application is to review AGT's revenue requirements for 1986 and 1987 and to determine appropriate rate adjustments.



The Telecom Canada microwave radio route transmits CTV's television signal to Calgary.

Throughout 1986 AGT kept Albertans informed about the more significant activities of the Company. Topics such as the expanded Extended Flat Rate Calling and the Individual Line Service programs were covered. Special attention was also given to promoting AGT's involvement with the 1988 Olympic Winter Games.

A new visual identity was developed to present AGT as an innovative, market-responsive, high-technology company. Testing of the new logo confirmed that the updated design projects AGT as a total communications provider in Alberta.

A new visual identity for AGT was developed in 1986.

In keeping with AGT's aim to contribute to the cultural, educational and social well-being of Albertans, the 1986 corporate contributions program responded to requests from across the province. Of particular note was the endowment to the Business Faculty at the University of Alberta, support of the Alberta Winter Games in Edson, Calgary's YMCA building campaign and continuation of AGT's program to provide mobile telephones to the Canadian Paraplegic Association and the Rotary Club. The Company also continued its support of an outstanding student through the Shad Valley program and the member agencies of the United Way.

THE OLYMPIC PROJECT

While the City of Calgary is putting the final touch on its preparations for the 1988 Olympic Winter Games, AGT's Olympic Project Group is busy completing the telecommunications requirements which will bring the pictures, sounds and results of one of the largest international sports events to the world.

In September 1986, AGT successfully concluded negotiations with OCO'88, the Olympic Organizing Committee for the Games, and we are proud that our expertise has been recognized in our designation as "Official Supplier of Telecommunications Services for the XV Olympic Winter Games".

Above: *Kim Hysert installs AGT services at the Nakiska Olympic site.*

Opposite: *AGT was named "Official Supplier of Telecommunications Services" for the 1988 Olympic Winter Games.*

Under the terms of this agreement, AGT will provide: the engineering design, installation, maintenance and removal of the telecommunications services; personnel for the detailed planning and co-ordination of specific telecommunications services; and the telecommunications network for all Olympic telecommunications users.

The Olympic Project Group has been established to co-ordinate the efforts of all AGT departments to meet the telecommunications needs related to the Olympic Games. At the end of 1986, 13 AGT employees were working full-time on the project, and that number will grow to a full complement of 300 people by the beginning of the Games. And, five employees are on loan to the Olympic Organizing Committee until the completion of the Games.

AGT's status as an Official Supplier to the 1988 Olympic Winter Games provides many marketing opportunities. Programs will be implemented to promote further sales to customers coming to Calgary for the Olympics, and to enhance the Company's image with all its publics.

AGT A YEAR OF GROWTH

To respond to growing opportunities in the telecommunications field, AGT established and actively participates in three subsidiary companies and one joint-venture operation.

Alta Telecom International Ltd.
Alta Telecom Inc.

Alta Telecom International Ltd. (ATI), and Alta Telecom Inc. (ATInc.) market AGT technology offshore and in the United States. Since ATI's inception in 1982, and the incorporation of ATInc. in 1984, both companies have experienced significant growth with 1986 revenues approaching $23 million. Currently 150 people are employed throughout the operation.

In May 1986, Graham Pollock was appointed President and Chief Executive Officer of the two companies. Mr. Pollock brings impressive credentials to the position through extensive business experience in the United States, the United Kingdom, Algeria, India and Australia.

ATI's corporate headquarters are located in Calgary, Alberta with branch offices in Thailand, Indonesia, Egypt, Puerto Rico and Australia. The United States market is serviced by Alta Telecom Inc., headquartered in Norcross, Georgia.

Worldwide, ATI provides consulting, technical assistance, software and customized systems, and high technology training.

In Egypt, a multi-million-dollar contract was signed to provide a microwave and mobile radio system for the Petroleum Pipeline Company. As the prime contractor, ATI is responsible for the engineering, design, supply and implementation of this state-of-the-art communications network.

In Puerto Rico, where a large software systems project was completed in 1985, further work was awarded to ATI for consulting activities. From its base in San Juan, ATI actively pursues other business opportunities in the Caribbean.

During 1986, ATI completed an advanced traffic engineering training program for the Telephone Organization of Thailand, and was contracted by the New Zealand Post Office for the recruitment of telephone personnel.

ATI's prospects for 1987 are excellent. It is concentrating its marketing drive in Thailand, Indonesia, Egypt, the Caribbean, Australia and New Zealand.

ATInc. is showing increasing success in the U.S. marketplace and, in the past year, major contracts have been awarded to both the Telecommunications and Systems Divisions.

In the software field, ATInc. was recently awarded contracts with three Bell Operating Companies to supply customized operating and surveillance systems. These contracts are in addition to the ongoing contracts with a major automobile manufacturer.

In the digital switching and fibre optics field, ATInc.'s reputation continues to grow with an ever-increasing customer base. In the past year, the Company successfully completed major contracts with Bell Operating Companies and non-regulated Long Distance Carriers, as well as expanding on its installation and commissioning contracts with most of the principal equipment manufacturers.

Overall ATInc. continues to fulfill its excellent growth potential and is aggressively expanding its involvement in the marketplace, especially in the area of government contracts and private networks.

Opposite: *ATI signed a multi-million-dollar contract to provide a microwave and mobile radio system in Egypt.*

Alta-Can Telecom Inc.
AGT's venture-capital subsidiary, Alta-Can Telecom Inc., actively promotes the telecommunications-related high technology industry in Alberta.

In 1986, two new investments were announced by the Spurt Investment Fund I, a limited partnership initiated by Alta-Can to inject seed funding into potential new enterprises.

In May, Spurt invested $250,000 for a twenty-three percent equity position in Omara Systems Inc. of Edmonton, designers of a heat-tracing controller for refineries and petrochemical plants.

Above: *The award-winning PT Protocol Tester is a major product of Idacom Electronics Ltd.*

Opposite: *Microchips are an integral part of high technology industry.*

Omara was also selected to design and manufacture an innovative remote control system for lighting and power along Jasper Avenue in Edmonton.

Spurt's second investment was in Information Dynamics Corporation. This Calgary-based company is developing a unique, point-of-sale controller for retail outlets. Its first product is designed for service station operations to record transactions, credit-card authorizations, sales management and inventory controls. A major independent petroleum marketer is currently participating in the prototype testing program.

During the year, Spurt grew from a $3-million to a $5-million fund. Through a commitment by the provincial government, the fund will be used to expand technological industrialization in Alberta. Plans call for the investment of $1 million annually over the next four years.

Alta-Can Telecom continues to hold a substantial financial position in a number of growing enterprises: Idacom Electronics Ltd., an Edmonton manufacturer of test equipment for digitized data networks; Innovage Microsystems Inc., a Calgary company producing a hand-held testing device for microprocessor circuits; and Cybernex Ltd., an Ottawa-based manufacturer of video display terminals.

This year Alta-Can completed its first full-cycle investment with the divesture of Telematic Products Inc., a Washington-based teleprocessing company. The company was purchased by Vodavi Technology Corporation of Phoenix, a publicly-traded U.S. company.

NovAtel Communications Ltd.
NovAtel Communications Ltd. is owned jointly by AGT and NOVA, AN ALBERTA CORPORATION. Formed in 1983, NovAtel actively pursues the manufacturing and marketing of cellular mobile radio telephones and systems on a global scale.

In 1986, NovAtel became one of the largest cellular telephone suppliers in North America. The Company is also one of the top mobile suppliers in the United Kingdom.

In the United States, NovAtel was recently awarded a contract by Century Cellunet Inc., a Louisiana-based company, for the construction of a cellular system which is expected to be in service by February, 1987 and will provide the model for additional Century systems in the United States.

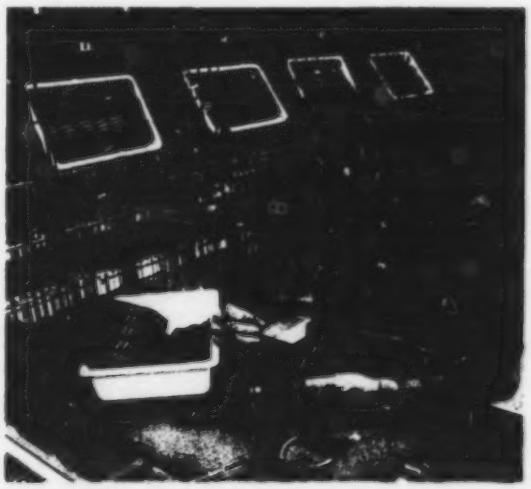
In the United Kingdom, the Carphone Group, the largest U.K. private supplier of mobile phones, entered into agreements with Volvo and Ford Motor Company of Britain to install NovAtel telephones as an optional feature in their new automobiles.

Further to the installation of cellular service in Chongqing, China, NovAtel was awarded a contract to expand the system's capabilities and geographical coverage. The Company is also pursuing marketing opportunities in Australia and New Zealand.

The major Canadian development this year was the introduction of the 800 MHz service to Calgary. In addition, NovAtel shipped Phase II of NorthWesTel's cellular system, adding eight more cell sites to its existing 400 MHz system.

Several new products resulting from NovAtel research and development were introduced during the year, including a smaller, lighter handset and a transportable battery-powered phone.

Worldwide, NovAtel employs 640 people in the Lethbridge plant, the Calgary head office and research and development centre, and sales offices in Vancouver, Edmonton, Toronto, Montreal, Fort Worth, Atlanta and England.



Above: *Kevin Stenson performs intricate work on a cellular telephone handset at the NovAtel Lethbridge plant.*

Opposite: *NovAtel Communications Ltd. is one of the largest cellular telephone suppliers in North America. This compact control unit allows for hands-free operation of a cellular telephone.*

AGT

FINANCIAL REVIEW

AGT's Directional Plan was prepared in response to fundamental changes taking place in the technological and competitive environments. Of the many thrusts embodied in the plan, those with the greatest financial impact are felt to be:

- The emphasis on making use of the latest available technology.
- The further orientation toward customer service.
- The focus on upgrading Human Resource qualifications and management systems.

This review attempts to illustrate the financial effects of these directional initiatives.

Capital Expenditures

The financial success of AGT will continue to depend on the provision of a modern, universally-accessible network.

The rapid expansion of the network has enabled AGT to invest in new technology as it becomes available. Alberta's per capita investment in telecommunications facilities is some 36%* higher than the national average. Clearly Albertans value this investment since usage, as measured by revenue per capita, is 37%* greater than the Canadian average, while rates for equivalent services are generally lower. AGT is therefore convinced that the provision of a technologically superior network is the foundation of its success and benefits its customers by providing a high level of service at the lowest possible cost.

Cost control measures in 1983-85 necessitated that capital expenditures be kept to a minimum level. However, with improved operating results and an emphasis on planning for future customer demands, 1986 saw the introduction of a network improvement program which will be effected over a five-year period. This program includes:

- Facilities for provision of Individual Line Service to customers currently using multi-party lines.
- Additional network modernization, primarily in digitizing the switching devices of central telephone exchanges. Presently some 37% of our switching capacity is digital. By 1991, 100% digitization is anticipated.
- Providing extended flat-rate calling to more Albertans by expanding the local calling area boundaries.

In order to minimize the burden on local rates, a portion of the Individual Line Service project is to be funded by the provincial government and the remainder by specific charges to individual customers.

The current year's capital expenditures of $226.2 million included $25.8 million for the network improvement program for which $16.2 million government funding is anticipated.

For the period 1987-1990, it is estimated that an additional $480 million will be spent on the improvement program out of total estimated capital expenditures of $1 452 million. This will be financed primarily by internally generated funds with some additional debt issues. The capital expenditures planned for 1987 are $381 million which will be financed mainly from operations with $87 million being financed through additional debt.

* Statistics Canada—Telephone Statistics 1985. Includes 'edmonton telephones'. AGT's comparable statistics would be investment per capita 49% higher and revenue per capita 50% higher than national average.

Operating Revenues

Growth in AGT's revenues, in an increasingly competitive environment, is dependent on continued enhancements to customer service while maintaining competitive rates.

Selected Statistics	% Change 86/85	1986	1985
Long Distance Messages (Millions)			
- In-Province	3.6	177.1	171.0
- Out-of-Province	9.0	71.1	65.2
TOTAL	5.1	248.2	236.2
Network Access Lines (Thousands)			
- Business	4.7	289.4	276.4
- Residence	1.5	648.7	638.8
TOTAL	2.5	938.1	915.2
Messages/Lines	2.7	265	258
Revenue ($Millions)			
Toll - In-Province	(1.9)	$366.6	$373.8
- Out-of-Province	7.3	335.7	313
Total Toll	2.3	702.3	686.8
Local	(5.4)	314.9	332.9
Other (net of uncollectible)	14.0	49.9	43.8
TOTAL	.3	1,067.1	1,063.5

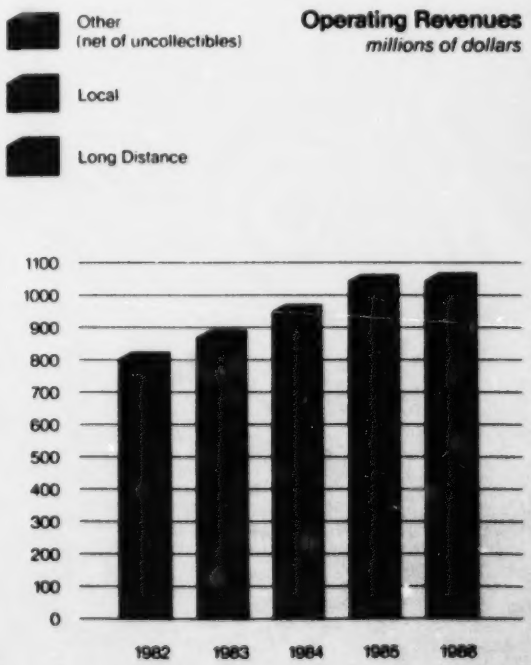
AGT's revenues are subject to fundamental changes in the marketplace. Alberta's economy can no longer be expected to produce the dramatic growth in demand for telecommunication services experienced in the late 1970s. Terminal rental revenue continues to be eroded by customers purchasing their own equipment, with margins on sales decreasing due to the intense competition in the Alberta market.

The 1986 revenues of $1,067.1 million represents a growth of .3% over 1985. The reason for the marginal growth is twofold. Firstly, AGT's 1985 revenues had the benefit of a 4.85% deficiency rider to recover revenue shortfalls from previous years. Secondly, Alberta's economy has taken a downturn as a result of the drop in world oil prices early in 1986.

The slight increase in revenues demonstrates the importance of an efficient, versatile network. In spite of the decline in the resource and agriculture sectors of the economy, innovative marketing of the network resulted in long-distance messages growing by 5.1% and access lines increasing by 2.5%.

The telecommunications industry is moving toward further deregulation. Some 25% of AGT's revenue is already subject to competition. AGT's rating plan is designed to smooth the transition. Both long distance and local rates are lower than the Canadian average.* Some adjustment of tariffs to bring rates more into line with costs will be considered at the rate review currently before the Public Utilities Board.

* Federal-Provincial Examination of Telecommunications Pricing and Universal Availability of Affordable Telephone Service.



Operating Expenses

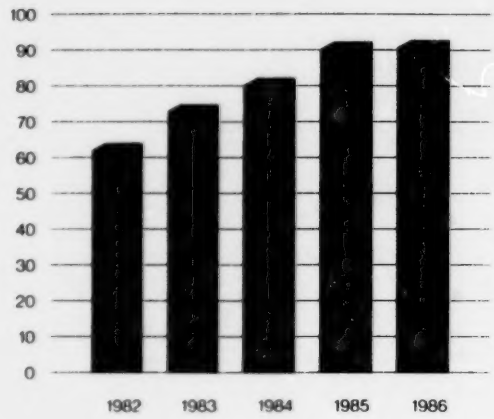
Steady improvement in productivity is being achieved by investment in increasing human resource skills and advanced management systems.

Since 1981 AGT has made substantial productivity improvements. The number of employees has been reduced by 15% while business volumes have continued to increase. Over the period 1981-86, AGT experienced an 12% growth in access lines and a 25% increase in long-distance messages. Revenues per employee have increased by 71% while rates increased by 18%.

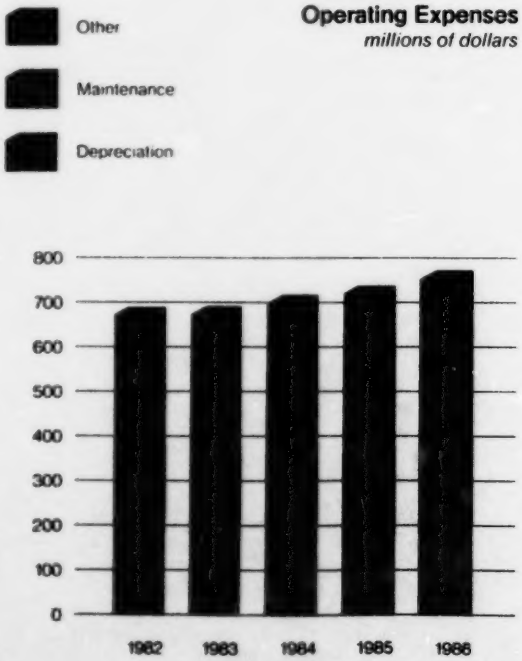
In 1986 a substantial reorganization was undertaken. Further productivity gains can be expected as a result of current plans and programs to upgrade human resource skills and management systems. This pattern is reflected in the 1986 results which saw total operating expenses increase from $739.9 million in 1985 to $771.4 million—representing a 4.3% increase. While maintenance, traffic, and commercial and marketing expenses were decreasing by 1.6%, general and administration expenses increased by 6.3%.

The 12.5% increase in depreciation expense is attributable partly to increases in depreciable property, but mainly to planned earlier retirement of assets which will be replaced through the network improvement program.

Revenue per Employee
Thousands of dollars



Operating Expenses
millions of dollars



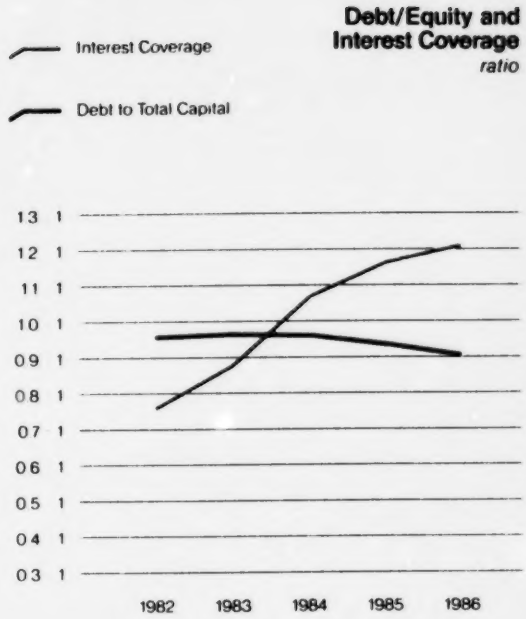
Earnings and Financing

AGT's objective is to manage its affairs in a manner that is comparable to private enterprise companies of similar size and risk without direct financial assistance from the provincial government.

The 1986 consolidated net income before extraordinary items shows an increase of 27.4% over 1985, the fourth consecutive year of substantial improvement. This represents a return on total average invested capital of 13.8%. This improved financial performance resulted primarily from reduced interest costs and capital gains realized from the trading of sinking fund investments. Interest on short-term debt was substantially reduced and new long-term debt was issued at an effective cost of 9.99% compared with the embedded debt cost of 12.89%.

Cash generated from operations increased by $16 million over 1985. AGT was able to finance its capital expenditures entirely through internally-generated funds and reduce its net indebtedness by $71 million. Long-term debt of $150 million was issued in 1986 to finance the repayment of maturing debentures and meet sinking fund requirements. With the steady improvement in earnings in the last few years, AGT has continued to improve its debt to total capital and interest coverage ratios (see graph). Debt accounted for 91.7% of total capital in 1986 compared to 94.7% in 1985; interest coverage increased to 1.22 in 1986 over 1.17 in 1985.

Debt/Equity and Interest Coverage
ratio



Future Prospects

AGT's management has great confidence in continued improvement in financial performance.

Despite the problems in the agriculture and oil and gas sectors of the Alberta economy, prospects for the future look good. Strengthening in the Canadian economy and the availability of new services are expected to produce revenue growth in 1987 and beyond. The benefits of the recent reorganization will progressively improve profitability. But the single most significant factor justifying confidence in the future is the potential for revenue generation in the continuously improving network.

AGT

MANAGEMENT REPORT

February 28, 1987

Management's Responsibility for Financial Statements

The accompanying consolidated financial statements and information in the Annual Report are the responsibility of management and have been approved by the AGT Commission. The financial statements have been prepared in conformity with Canadian generally accepted accounting principles and of necessity include some amounts that are based on estimates and judgments. Financial information presented throughout the Annual Report is consistent with that in the consolidated financial statements.

To discharge its responsibility for the integrity and objectivity of financial reporting, management maintains a system of internal accounting controls comprising written policies, standards and procedures, a formal authorization structure, and an internal audit program. This system is designed to provide management with reasonable assurance that transactions are properly authorized, reliable financial records are maintained, and assets are adequately accounted for and safeguarded. The Company has also established a Code of Business Ethics and corporate directives which require communication of the Code to employees.

The Commission carries out its responsibility for the financial statements through its Audit Committee, which consists entirely of members of the AGT Commission. This Committee meets periodically with management and the auditors to discuss and review audit and financial matters, and recommends the financial statements to the Commission for approval. The Company's external auditor has full and free access to the Audit Committee.

The Auditor General of Alberta, the Company's external auditor, appointed through The Alberta Government Telephones Act, is engaged to provide an independent audit of the consolidated financial statements. The Auditor's Report follows.

On behalf of Management,

H.M. Neldner
President

F.J. Parrotta
Vice-President—Finance
Edmonton, Alberta

AUDITOR'S REPORT

ALBERTA LEGISLATURE
OFFICE OF THE AUDITOR GENERAL

To the Members of
The Alberta Government Telephones Commission

I have examined the consolidated balance sheet of The Alberta Government Telephones Commission as at December 31, 1986 and the consolidated statements of income and retained earnings and changes in financial position for the year then ended. My examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, these consolidated financial statements present fairly the financial position of the Commission as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Donald D. Salmon

C.A.
Auditor General
Edmonton, Alberta

February 28, 1987

AGT

Consolidated Balance Sheet

as at December 31, 1986
(thousands of dollars)

Assets

	1986	1985
Telephone Property, at cost:		
Buildings and equipment	$ 3 021 294	$ 2 932 434
Less: Accumulated depreciation	1 258 304	1 106 137
	1 762 990	1 826 297
Land	45 815	45 916
Plant under construction	79 384	37 389
Materials and supplies	57 138	54 317
	1 945 327	1 963 919
Unamortized Station Connection Costs (Note 4)	—	22 998
Investments (Note 5)	28 249	8 428
Current:		
Cash and short term deposits	16 835	6 001
Accounts receivable	161 153	156 161
Grants receivable (Note 2d)	16 252	—
Prepaid expenses	18 408	13 882
Inventories for resale, at cost	22 924	30 905
Net investment in leases and mortgages (Note 6)	16 607	12 015
	252 179	218 964
Net investment in Leases and Mortgages (Note 6)	40 455	40 860
Deferred Charges (Note 7)	46 106	55 406
	$ 2 312 316	$ 2 310 575

The accompanying notes are part of these consolidated financial statements.

Liabilities

	1986	1985
Long-Term Debt (Note 8)	$ 2 223 189	$ 2 203 983
Less: Sinking fund assets (Note 9)	469 110	366 802
	1 754 079	1 837 181
Current:		
Bank overdraft	808	9 541
Notes payable	155 035	134 466
Accounts payable	54 541	58 710
Wages payable	52 845	51 034
Accrued interest	56 961	61 521
Service billed in advance	33 577	29 450
Current portion of mortgages payable (Note 8)	431	396
	354 198	345 118
Deferred Revenue	30 221	17 537
Retained Earnings	173 818	110 739
Commitments and Contingent Liabilities (Note 10)		
	$ 2 312 316	$ 2 310 575

AGT

Consolidated Statement of Income and Retained Earnings

for the year ended December 31, 1986
(thousands of dollars)

	1986	1985
Operating Revenues:		
Long distance service	$ 702 315	$ 686 806
Local service	314 895	332 884
Other (Note 11)	60 283	55 921
Uncollectible operating revenues	(10 351)	(12 117)
	1 067 142	1 063 494
Operating Expenses:		
Depreciation	206 517	183 517
Maintenance	194 192	196 400
Traffic	34 889	35 668
Commercial and marketing	74 857	76 903
General and administration	213 988	201 328
Property and business taxes	25 144	24 013
Pension fund (Note 12)	21 803	22 076
	771 390	739 905
Net Operating Revenues	295 752	323 589
Other Income (Note 13)	75 415	38 732
	371 167	362 321
Interest and Other Deductions (Note 14)	286 132	290 621
Amortization of Station Connection Costs (Note 4)	22 998	22 998
Net Income Before Extraordinary Items	62 037	48 702
Extraordinary Items (Note 15)	1 042	—
Net Income for the Year	63 079	48 702
Restated Retained Earnings at Beginning of Year (Note 3)	110 739	62 037
Retained Earnings at End of Year	$ 173 818	$ 110 739

The accompanying notes are part of these consolidated financial statements.

Consolidated Statement of Changes in Financial Position

for the year ended December 31, 1986
(thousands of dollars)

	1986	1985
Operating Activities:		
Net Income Before Extraordinary Items	$ 62 037	$ 48 702
Items not requiring an outlay of cash:		
Depreciation and amortization	243 550	223 336
Other (Note 16)	23 578	1 000
Sinking fund earnings	(77 383)	(32 445)
Net change in non-cash working capital components (Note 16)	(25 172)	(27 892)
	226 610	212 701
Cash provided by extraordinary items	2 083	—
Cash provided by operating activities	228 693	212 701
Financing Activities:		
Proceeds from long-term debt issues	150 000	—
Repayment of long-term debt	(152 722)	(29 769)
Increase (decrease) in Notes payable	20 569	(35 587)
Cash provided by (used by) financing activities	17 847	(65 356)
Investing Activities:		
Capital expenditures	(226 165)	(180 688)
Less: items not requiring an outlay of cash	33 044	46 017
Increase in Materials and supplies	(2 821)	(3 827)
(Increase) decrease in Leases and mortgages	405	(11 701)
Increase in Investments	(31 436)	(1 525)
Cash used by investing activities	(226 973)	(151 724)
Cash and Cash Equivalents:		
Increase (decrease) during the year	19 567	(4 379)
Balance at beginning of year	(3 540)	839
Balance at end of year	$ 16 027	$ (3 540)

The accompanying notes are part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

December 31, 1986

Note 1 **Authority**

The Alberta Government Telephones Commission operates under the authority of The Alberta Government Telephones Act, Chapter A-23, Revised Statutes of Alberta 1980.

Note 2 **Summary of Significant Accounting Policies**

(a) Telephone Property

Telephone property is recorded at original cost and includes materials, direct labour, certain general overhead costs associated with construction activity and an allowance for funds utilized during construction. Materials and supplies are valued substantially at average cost.

The Commission continually reviews the application of this capitalization policy in accordance with accounting standardization policies of the Telecom Canada companies.

Resulting from this review, no changes in capitalization were made in 1986.

(b) Depreciation

Depreciation is provided on a straight-line basis using rates determined by a continuing program of engineering studies, calculated to allocate to operations the cost of groups of property with equal service lives over the estimated useful lives of the groups.

When depreciable telephone property is retired for reasons of exhausted service capacity, obsolescence, loss or destruction, the original cost of such property, adjusted by any disposal proceeds and costs of removal, is charged to accumulated depreciation. Gains or losses on disposal of depreciable telephone property are allocated to operations over the remaining estimated useful lives of appropriate property groups.

When depreciable telephone property subject to resale in the ordinary course of business (such as customer premise equipment) is sold, the original cost of such property less accumulated depreciation is netted against sale proceeds and the difference is reflected in Local service revenues.

The composite depreciation rate for the year ended December 31, 1986 was 7.27% compared to 6.23% for the previous year. Total depreciation of $219 688 000 (1985 $200 225 000) includes $11 792 000 (1985 $14 911 000) distributed to other operating expenses and $1 379 000 (1985 $1 797 000) distributed to telephone property.

(c) Translation of Foreign Currencies

Monetary assets and liabilities in foreign currencies are translated into Canadian dollars at the rate of exchange in effect at the balance sheet date. Other assets and liabilities and items affecting earnings are converted at the rate of exchange in effect at the date of the transaction.

Unrealized net exchange gains or losses are deferred and amortized over the remaining lives of the related assets and liabilities.

Realized exchange gains or losses are reflected in net income for the year.

Self-sustaining foreign operations are translated using the current rate method. Under this method, all assets and liabilities are translated into Canadian dollars at year-end exchange rates; revenue and expenses are translated at exchange rates in effect during the year. Net translation gains or losses arising from changes in exchange rates are treated as deferred charges.

(d) Deferred Revenue

Deferred revenue relates to the capital cost of equipment rented under operating leases and grants from the Government of the Province of Alberta under the Individual Line Service program. It is recognized as income on a straight-line basis over the estimated useful life of the related equipment. Deferred revenue to be recognized as income within one year is included with Service billed in advance.

The amount of grants credited to Deferred revenue in 1986 amounted to $16 252 000. $2 942 000 will be recognized as income in 1987.

(e) Amortization

Deferred charges, discounts or premiums on long-term monetary assets and liabilities are amortized on a straight-line basis over the remaining lives of the related assets and liabilities.

Where interest coupons and residuals are held as separate investments in Sinking funds, discounts are amortized over the period to maturity so as to produce a constant rate of return on the investments.

Intangible assets are amortized on a straight-line basis over a specified period.

(f) Investment in Leases

Unearned finance income related to sales-type leases is taken into income over the lease term to produce a constant rate of return on the investment in the lease.

(g) Consolidation

These consolidated financial statements include the accounts of wholly-owned subsidiaries, Alta Telecom International Ltd., Alta Telecom Inc., Alta Telecom Licensing Corporation, Alta-Can Telecom Inc. and 288922 Alberta Ltd. The investment in affiliated company, NovAtel Communications Ltd., is accounted for by the equity method. All significant transactions between these companies included in the consolidation have been eliminated, except for purchase of telecommunications equipment and supplies by Alberta Government Telephones from the affiliated company which are reflected in the Consolidated balance sheet at cost to the parent and are included in the Consolidated income statement. To the extent that any income related to these revenues has not been offset by depreciation or other operating expenses, it remains in Consolidated income and retained earnings. This practice is generally followed in regulated industries.

Note 3 **Prior Period Adjustment**

The 1985 Financial Statements have been restated to adjust the amortization of costs related to a 1983 intercompany transaction. The opening retained earnings balance for 1985 has been increased by $974 000 for the portion applicable to 1983 and 1984 while Net Income for 1985 has been increased by $486 000.

Note 4 **Amortization of Station Connection Costs**

The balance of undepreciated capital costs for the installation of customer premise equipment as at December 31, 1984 was amortized over a two-year period beginning January 1, 1985 in conjunction with a change in capitalization policy. $22 998 000 has been included as Amortization of Station Connection Costs in each of the years 1985 and 1986 in determining Net Income Before Extraordinary Items.

Note 5 **Investments**

Investments consist of the following:

	1986	1985
NovAtel Communications Ltd. (held by 288951 Alberta Ltd.) 100 common shares without par value, and 3 117 100 preferred shares, at equity	$ 21 106 276	$ 231 236
Telesat Canada 279 900 common shares without par value, at cost	2 799 000	2 799 000
Cybernex Ltd. (held by Alta-Can Telecom Inc.) 150 000 common shares without par value and 2 000 preferred shares without par value, at cost	2 000 015	2 000 015
Telematic Products, Inc. (held by Alta-Can Telecom Inc.) 285 714 preferred shares, par value $ .10 U.S. at cost	–	1 300 399
Vodavi Technology Corporation (held by Alta-Can Telecom Inc.) 161 290 common shares without par value, at cost	1 119 191	–
Idacom Electronics Ltd. (held by Alta-Can Telecom Inc.) 30 395 common shares without par value, at cost	550 000	550 000
Woods Alta Group (held by Alta Telecom Inc.) Unincorporated Joint Venture, at equity	–	870 637
Other investments, at cost	674 252	676 335
	$ 28 248 734	$ 8 427 622

As of January 1, 1986 the unincorporated telecommunications joint venture undertaking carried out through subsidiary company 288951 Alberta Ltd. was terminated and the assets and liabilities sold in exchange for 55.5 common shares and 3 116 600 preferred shares in NovAtel Communications Ltd.

All outstanding and issued shares of Telematic Products Inc. were purchased by Vodavi Technology Corporation. Telematic shares held by Alta-Can Telecom Inc. were exchanged for 161 290 common shares of Vodavi Technology Corporation.

Note 6 **Net Investment in Leases and Mortgages**

The net investment in leases and mortgages results from the sale of assets to customers under a lease purchase plan and from the sale of rental homes to employees. Principal due within one year has been reclassified under current assets.

Net investment in leases and mortgages consists of the following:

	1986	1985
	(thousands of dollars)	
Total minimum lease and mortgage payments receivable	$ 71 501	$ 68 925
Unearned finance income	(14 439)	(16 050)
	57 062	52 875
Less: Current portion	16 607	12 015
	$ 40 455	$ 40 860

Note 7 **Deferred Charges**

Unamortized deferred charges consist of the following:

	1986	1985
	(thousands of dollars)	
Unrealized exchange loss, net	$ 29 301	$ 37 045
Debenture discounts	9 659	9 095
Other	7 146	9 266
	$ 46 106	$ 55 406
Amortization charged to net income for the year	$ 9 566	$ 9 657

Note 8 **Long-Term Debt**

Long-term debt is summarized as follows:

	1986	1985
	(thousands of dollars)	
Debentures payable in United States funds, maturing 1987 to 1996, bearing interest at 4.75% to 9.50%	$ 203 669	$ 204 910
Exchange premium, net, at dates of issue	13 391	13 421
Unrealized exchange loss	64 105	68 195
	281 165	286 526
Debentures payable in Canadian funds, maturing 1987 to 2003, bearing interest at 6.00% to 17.75%	1 930 396	1 905 396
Mortgages payable in Canadian funds, repayable in monthly instalments, maturing 1995 and 1999, bearing interest at 8.25% and 11.50%	12 059	12 457
Less: Principal included in current liabilities	431	396
	11 628	12 061
	$ 2 223 189	$ 2 203 983

(a) Debentures are unconditionally guaranteed as to principal and interest by the Government of the Province of Alberta.

(b) In accordance with debenture deeds, certain issues require annual sinking fund contributions of 1.00% to 2.00% of the principal amounts outstanding. Contributions are required during periods varying from 15 to 25 years before maturity.

(c) Certain debentures have early redemption provisions at the Commission's option during periods prior to maturity varying from 2 to 4 years for Canadian dollar issues and 10 to 13 years for United States dollar issues.

(d) Amounts of debentures repayable within one year are classified as long-term debt inasmuch as it is anticipated that payments will be made from the proceeds of refinancing rather than from current assets.

(e) Anticipated requirements to meet long-term debt repayments and sinking fund provisions during the next five years (excluding exchange on debt repayments to be made in United States funds), are as follows:

Year	Debenture Redemptions	Mortgages	Sinking Fund Provisions	Total
		(thousands of dollars)		
1987	$ 376 302	$ 431	$ 24 003	$ 400 736
1988	1 367	469	24 003	25 839
1989	100 000	510	23 498	124 008
1990	–	555	22 895	23 450
1991	100 000	604	21 175	121 779
	$ 577 669	$ 2 569	$ 115 574	$ 695 812

(f) In 1986 the Alberta Government Telephones Commission offered to the public a $200 000 000 debenture issue at 9% to be dated January 15, 1987, maturing January 15, 1997. The proceeds will be used to repay short-term notes payable and for other purposes of the Commission. The debenture is unconditionally guaranteed as to principal and interest by the Government of the Province of Alberta.

Note 9 **Sinking Fund Assets**

Sinking fund assets relate to the Commission's debenture debt and consist of the following:

	1986	1985
	(thousands of dollars)	
Investments:		
Debentures, at amortized cost:		
Government of Canada, direct and guaranteed	$ 295 862	$ 246 451
Provincial, direct and guaranteed	47 896	26 545
Investment in the Commission's own debentures, at amortized cost	66 857	63 902
Unrealized exchange gain	14 720	14 850
(Approximate market value: 1986 $504 441; 1985 $429 039)	425 335	351 748
Cash	19	20
Short-term deposits	39 069	11 939
Accrued interest	4 687	3 095
	$ 469 110	$ 366 802

Note 10 **Commitments and Contingent Liabilities**

The Commission is committed to aggregate rental payments of $13 646 000 under leases having an initial term of more than one year. Minimum annual rental payments during the next five years are as follows:

Year	Rental payments (thousands of dollars)
1987	5 495
1988	2 984
1989	1 857
1990	1 088
1991	576

The Commission and its subsidiaries are contingently liable for $2 896 000 in the form of letters of credit and guarantees.

Legal action has been initiated against a subsidiary of the Commission by a subcontractor of its joint venture seeking damages of $2 030 000 U.S. The claim is being defended and in managements opinion, the outcome of this action will have no adverse material impact on the Commission's financial statements.

Note 11 **Other Operating Revenues**

Other operating revenues consist of the following:

	1986	1985
	(thousands of dollars)	
Directories	$ 31 736	$ 28 653
Rentals	10 391	12 185
Miscellaneous	18 156	15 083
	$ 60 283	$ 55 921

Note 12 **Pension Fund**

The Commission makes regular contributions to The Alberta Government Telephones Employees' Pension and Death Benefit Fund which provides service pensions calculated as a function of earnings and years of service. An actuarial review as at December 31, 1985 indicated that the assets of the Fund together with the contributions expected to be received from the members of the Fund were sufficient to provide the benefits under the Fund as they fall due.

Note 13 **Other Income**

Other income consists of the following:

	1986	1985
	(thousands of dollars)	
Sinking fund income	$ 77 383	$ 32 445
Allowance for funds utilized during construction	3 774	4 125
Dividends from investment in Telesat Canada Shares	28	140
Net loss in affiliated companies	(10 574)	–
Miscellaneous	4 804	2 022
	$ 75 415	$ 38 732

Note 14 **Interest and Other Deductions**

Interest and other deductions consist of the following:

	1986	1985
	(thousands of dollars)	
Interest and exchange on long-term debt	$ 272 026	$ 266 061
Interest on short-term debt	4 766	13 369
Amortization of unrealized exchange loss, net	4 978	5 824
Amortization of debenture discount	1 699	2 105
Other deductions	2 663	3 262
	$ 286 132	$ 290 621

Note 15 **Extraordinary Items**

Extraordinary items in 1986 consist of the following:

A gain of $2 083 000 on the sale to NovAtel Communications Ltd. of the assets and liabilities of the terminated joint venture.

The Commission's share of the loss, amounting to $789 000 incurred in the closure of a manufacturing plant in Montreal by NovAtel Communications Ltd.

A loss of $252 000 incurred in conjunction with the exchange of shares in Telematic Products Inc. and Vodavi Technology Corporation.

Note 16 **Changes in Financial Position**

	1986	1985
	(thousands of dollars)	
Other Items Not Requiring an Outlay of Cash:		
Premiums, discounts and exchange	$ 7 378	$ 8 536
Increase in deferred charges	(3 284)	(4 048)
Increase in deferred revenue	12 684	637
Allowance for funds used during construction	(3 774)	(4 125)
Net Loss in affiliated companies	10 574	–
	$ 23 578	$ 1 000
Net Change in Non-cash Working Capital Components:		
Increase in accounts receivable	$ (4 992)	$ (23 175)
Increase in grants receivable	(16 252)	–
Increase in prepaid expenses	(4 526)	(1 001)
(Increase) decrease in inventories for resale	7 981	(14 138)
Increase in investment in leases and mortgages	(4 592)	(3 694)
Increase (decrease) in accounts payable	(4 169)	15 536
Increase (decrease) in wages payable	1 811	(5 862)
Increase (decrease) in accrued interest payable	(4 560)	3 899
Increase in service billed in advance	4 127	543
	$ (25 172)	$ (27 892)

Note 17 **Related Party Transactions**

During 1986, the Commission purchased equipment, materials and related supplies from NovAtel Communications Ltd. in the amount of $13 630 000 (1985 $10 875 000) which represented approximately 13% (1985 22%) of the sales of NovAtel.

There were no material transactions with other related companies.

Note 18 **Subsequent Event**

On April 24, 1985 representatives of the City of Edmonton and the Government of Alberta signed a Memorandum of Understanding which established an Arbitration Committee to hold hearings to "develop or select a practical toll-sharing formula for the sharing of toll revenues generated in the City of Edmonton."

On February 28, 1987, the Arbitration Committee released its decision outlining a basis for toll revenue sharing which is effective January 1, 1985. Under the Committee's formula 'edmonton telephones' will receive $10 226 060 for the first three months of 1985 out of toll revenues generated in the City of Edmonton. On an annualized basis this would amount to an estimated $43 175 169 for 1985.

This amount will be reduced by $15 631 334 already paid by the Commission under existing agreements, thus leaving an additional amount of $27 543 835 to be paid to 'edmonton telephones' for 1985. The Committee stated that the amounts payable under the formula in subsequent years "may be of the like order, depending upon various factors."

In management's opinion, the effect of this additional liability of $27 543 835 on the income of the Commission will be reduced by amounts claimable in revenue settlements with other members of Telecom Canada, and by other potential administrative costs. Due to the timing of the Arbitration Committee's decision and the complexities involved in establishing these amounts, the net impact on the income of the Commission for 1985 and 1986 cannot be reasonably estimated at this time. Accordingly, these financial statements have not been adjusted to reflect the Arbitration Committee's decision.

Note 19 **Comparative Figures**

The 1985 figures have been reclassified where necessary to conform to 1986 presentation.

The format of The Statement of Changes in Financial Position has been changed to that recommended by The Canadian Institute of Chartered Accountants in September 1985. The focus of the revised format is on the cash and cash equivalents available to the enterprise rather than the working capital format used previously.

Note 20 **Approval of Financial Statements**

These financial statements were reviewed by the Audit Committee of the Alberta Government Telephones Commission and recommended for approval by the Commission.

AGT

Historical Summary

	1986	1985	1984
FINANCIAL POSITION *(in thousands)*			
TOTAL PLANT INVESTMENT	$ 3 146 493	$ 3 015 739	$ 3 139 373
ACCUMULATED DEPRECIATION	1 258 304	1 106 137	1 126 483
LONG-TERM DEBT	2 223 189	2 203 983	2 202 480
RETAINED EARNINGS	173 818	110 739	61 063
INCOME *(in thousands)*			
OPERATING REVENUES	$ 1 067 142	$ 1 063 494	$ 970 385
OPERATING EXPENSES	771 390	739 905	720 040
OTHER INCOME	75 415	38 732	61 050
INTEREST AND OTHER DEDUCTIONS	286 132	290 621	289 281
EXTRAORDINARY/OTHER ITEMS	(22 998)	(22 998)	(10 999)
NET INCOME (LOSS)	63 079	48 702	11 115
CAPITAL EXPENDITURES *(in thousands)*	$ 226 165	$ 180 688	$ 215 922
TOTAL PAYROLL *(in thousands)*	$ 385 944	$ 372 435	$ 357 032
CORPORATE STATISTICS			
TOTAL EMPLOYEES	11 407	11 477	11 799
SUBSCRIBER LINES IN SERVICE*	938 073	915 149	887 284
LONG DISTANCE MESSAGES *(in thousands)*	248 249	236 207	214 357
CENTRAL OFFICE EXCHANGES	436	434	430
EMBEDDED COST OF LONG-TERM DEBT (OUTSTANDING PROCEEDS)	12.89%	13.10%	12.98%

* Subscriber lines have been redefined this year to conform to the more common industry definition.

1983	1982	1981	1980	1979	1978	1977
$ 3 054 239	$ 2 976 148	$ 2 657 077	$ 2 244 861	$ 1 932 576	$ 1 678 979	$ 1 476 011
1 004 047	884 195	786 917	638 309	516 193	420 808	344 202
2 288 241	2 248 756	1 916 270	1 644 034	1 437 719	1 303 090	1 167 911
49 948	72 862	129 338	128 282	103 534	79 152	63 281
$ 892 750	$ 825 346	$ 734 462	$ 636 828	$ 529 018	$ 443 471	$ 367 811
695 642	690 577	596 546	498 153	407 616	338 838	288 464
51 751	51 115	41 303	25 608	19 087	15 422	14 734
279 818	242 360	178 163	139 535	116 107	104 184	90 220
8 045	—	—	—	—	—	—
(22 914)	(56 476)	1 056	24 748	24 382	15 871	3 861
$ 222 809	$ 473 516	$ 480 014	$ 380 957	$ 314 313	$ 261 070	$ 246 186
$ 359 675	$ 351 061	$ 307 995	$ 258 790	$ 214 825	$ 189 045	$ 169 841
11 926	12 814	13 429	12 326	11 229	10 696	10 357
869 053	861 164	839 369	783 367	721 911	667 495	620 366
205 808	205 420	198 930	177 788	148 957	126 654	109 456
420	424	408	402	398	387	379
12.58%	12.35%	11.28%	9.87%	8.93%	8.68%	8.35%

A portion of the subscriber lines for 1977-1984 has been estimated in order to provide comparative figures.

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Assistant Vice-President Human Resources	*W.D. Montgomery*
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